

## Roads Leading Nowhere

*Reuven Brenner, Labyrinths of Prosperity: Economic Follies, Democratic Remedies, The University of Michigan Press, Ann Arbor, 1994*

*Reviewed by Michael James*

**I**N the late 1970s it looked as if Keynes was dead. But as Paul Krugman shows in *Peddling Prosperity* (1994), he was quietly revived in the 1980s. And the response to the recession of the early 1990s showed that Keynes still had a central place in the public imagination. Encouraged by recidivist chatter about 'kickstarting' and 'the multiplier', and Australian Prime Minister Paul Keating's loose talk about the levers in his pocket, everyone suddenly seemed to 'know' that governments could create jobs by resorting to budget deficits. Economic commentary in the media is dominated by the great macroeconomic aggregates. The Keynesian revolution is apparently complete.

According to Reuven Brenner, a Professor of Management at McGill University, emphasis on macroeconomics has locked us into a range of fallacies, liberation from which will require not only intellectual but also institutional changes. The most obvious sign of our thralldom is what Brenner calls our 'illusions of precision': the conviction that statistics can in principle come up with indicators reliable and meaningful enough to ensure policy success. One problem here is surely the media's demand for easy news and the financial commentators' eagerness to supply it by droning endlessly and forgettably on about 'the numbers', especially when they are staging their monthly mercantilist melodrama about the nation's 'import bill'. And although we do every so often remind ourselves of the shortcomings of indicators, we soon forget them and carry on as before. But Brenner tries to incorporate the limitations of statistics in a serious reform proposal. Central banks should be made responsible solely for price stability, he says, but this stability should not be expressed as a precise target. Instead, bureaus of statistics should publish two price indices: one for unregulated markets, the other for regulated ones. They should also publish two series of price indices following significant changes in fiscal policy or import prices or a devaluation: one series would include the effects of the changes, the other exclude them. In all cases the margins of error should be made explicit and stressed.

Brenner's fundamental objection to macroeconomics is that it cannot answer the most important things we want to know about public spending and budget deficits. Do they create jobs or destroy them? Do they stimulate investment or crowd it out? Brenner thinks that the evidence is inconclusive, for the good reason that 'It all depends on what the government does with the money and on the timing of its expenditures' (p.19). He is impressed by the fact that America's growing budget deficits in the 1980s were accompanied by falling inflation and interest rates, and rising investment. He suggests that high defence spending increased Americans'

sense of security at a time of rising international tension, and so had the effect of crowding investment in rather than out. In this instance, defence spending was in line with Americans' preferences, and so amounted to an investment. In other circumstances such spending might not have reflected their preferences, so amounting to waste. But mere statistical aggregates, including those that break down spending into 'consumption' and 'investment', cannot distinguish between spending that does reflect citizens' preferences and spending that doesn't.

The need to interpret macroeconomic data in this way leads Brenner to be sceptical about the claim that higher national savings will promote higher investment and, therefore, growth. This belief encourages governments to cut spending in aggregate, even though some such spending represents true investment rather than a reduction in national saving. (Brenner himself doubts whether high saving and investment are a cause of prosperity, but thinks they are probably consequences of it.)

For Brenner, prosperity requires not so much a focus on national macroeconomies but rather an international emphasis on incentives to invest and access to capital markets. Just as commentators in 17th-century Europe wondered at the prosperity of Amsterdam but overlooked its actual causes (Brenner thinks they included fiscal responsibility, trustworthy institutions and financial innovativeness — he might have added a lack of statistics), so nowadays Western economists tend to make the same mistake with regard to the successful Asian countries. The first lesson we should learn is that in those countries macroeconomic policy stays in the background.

The question that Brenner's analysis leads to is this: how can we determine whether a public-spending program represents an addition to or a subtraction from a nation's wealth? This is where institutional reform is needed. Brenner observes that many Western governments have arrived at a condition of fiscal paralysis — what Jonathan Rauch has called 'demosclerosis' in a book so titled — whereby the ordinary political process vetoes serious spending cuts or tax increases. Recalling Joseph Schumpeter's observation that radical political change has often been triggered by state bankruptcy, Brenner thinks that the age of the popular initiative and referendum is at hand. These institutions, he argues, are going to be needed to reveal whether particular spending programs reflect citizens' preferences. As he shows, the number of important decisions — and not only constitutional ones — being made by referendum is slowly increasing. It is indeed quite likely that near-bankrupt countries like Italy, whose government has recently been close to defaulting on either public-debt interest payments or age pensions, will be forced to delegate fiscal-reform decisions directly to the people.

To bolster his argument, Brenner stresses the joys of Switzerland, a rich and peaceful country where institutionalised regular initiatives and referendums 'diminish the importance of politicians' opinions, theirs and bureaucracies' power, and incentives for lobbying groups to organise' (p.157). Indeed, the Swiss system produces politicians who are characterised by a deeply attractive ordinariness, absence of charisma, and, best of all, international anonymity: as Brenner says, 'one does not hear much about them' (p.156). Brenner is aware (as perhaps some pub-

lic-choice theorists are not) that direct democracy, in subjecting taxes and regulations to a more rigorous test than they receive under representative democracy, would not necessarily produce fewer of them. But this would not worry Brenner, for whom the issue is not how big or small government should be, but whether each intervention enhances national prosperity.

Brenner is on the right track in recommending a greater role for direct democracy in fiscal decisions. Nevertheless, if referendums are to do the job he wants them to, they need to be constrained in various ways; and advocates of direct democracy do typically recommend checks such as requiring initiatives to be endorsed by large proportions of voters, and referendums to be carried by qualified rather than simple majorities. Even so, voters, like politicians, can be mistaken about the effects of the programs they sanction; and some spending programs represent transfers rather than investments in public goods. The real strength of direct democracy lies in its potential to get rid of counterproductive programs that are too well defended by vested interests for the politicians to tackle unaided.

*Labyrinths of Prosperity* has several attractive features. Brenner shows how economists can draw on sociology, history and political science to supplement their analyses of the conditions of prosperity. The main text, written in plain but lively English, takes up only about two-thirds of the book; most of the technical analysis and supporting data are relegated to appendices and notes. Let Brenner have the last word, in a passage that usefully summarises and connects several of his main ideas:

In spite of worrying about deficits, some economists are still trapped in Keynesian semantics and talk about the stimulus of deficits, of spending on public works (now called 'infrastructure'). . . The issue is responsible governance and political institutions to enforce them [*sic*], rather than reliance on one or another economic theory, or one way or another of counting numbers. The theories are just frequently repeated opinions without foundation, and frequently the numbers bear no relationship to facts. The roads may lead nowhere, and the schools may produce illiterates with diplomas. (p.49)

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